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513036—43

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 693

L. & C. MAYERS CO., INC., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 37–42) is not reported. The opinion of the Circuit Court of Appeals (R. 65–66) is reported at 131 F. 2d 309.

JURISDICTION

The judgment of the Circuit Courts of Appeals was entered November 21, 1942 (R. 67–68). The petition for a writ of certiorari was filed February 1, 1943. Jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The Commissioner of Internal Revenue determined that the deduction claimed by petitioner for the salaries of its two officers was in excess of the "reasonable allowance" permitted by Section 23 (a) of the Revenue Act of 1936, and he accordingly reduced the deduction. The Board of Tax Appeals found that the petitioner had not sustained the burden of proving the Commissioner's determination erroneous. Was the Circuit Court of Appeals justified in affirming where the record supported the determinations below?

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

> ART. 23 (a)-6. *Compensation for personal services.*—Among the ordinary and necessary expenses paid or incurred in carrying on any trade or business may be included a reasonable allowance for salaries

or other compensation for personal services actually rendered. The test of deductibility in the case of compensation payments is whether they are reasonable and are in fact payments purely for services. This test and its practical application may be further stated and illustrated as follows:

(1) Any amount paid in the form of compensation, but not in fact as the purchase price of services, is not deductible. (*a*) An ostensible salary paid by a corporation may be a distribution of a dividend on stock. This is likely to occur in the case of a corporation having few shareholders, practically all of whom draw salaries. If in such a case the salaries are in excess of those ordinarily paid for similar services, and the excessive payments correspond or bear a close relationship to the stock holdings of the officers or employees, it would seem likely that the salaries are not paid wholly for services rendered, but that the excessive payments are a distribution of earnings upon the stock. * * *

* * * * *

(3) In any event the allowance for the compensation paid may not exceed what is reasonable under all the circumstances. It is in general just to assume that reasonable and true compensation is only such amount as would ordinarily be paid for like services by like enterprises under like circumstances. The circumstances to be taken into consideration are those existing at the date when

the contract for services was made, not those existing at the date when the contract is questioned.

STATEMENT

The facts found by the Board of Tax Appeals may be summarized as follows:

The taxpayer was engaged in the business of distributing diamonds, watches, jewelry and gift wares, mostly by mail order pursuant to catalogue. It had six sales offices and employed 13 salesmen. Its fiscal year ended June 30. (R. 34, 35.)

Taxpayer's stock was wholly owned by L. & C. Mayers Importing Corporation. Lawrence S. Mayers and Chauncey M. Mayers each owned one-fourth of the outstanding common stock of the Importing Company; their wives owned the remainder of the common and all of the preferred stock. (R. 34, 50.)

The taxpayer's board of directors consisted of the two Mayers brothers and their father. The brothers were the sole officers of the corporation, dividing the duties of administering the business equally between them. (R. 34.) They were also officers of the Importing Company and received compensation from it (R. 35).

Lawrence Mayers had charge of merchandising the gift wares and editing and assembling of that part of the taxpayer's annual catalogue which related to such merchandise. He also supervised the salesmen. Chauncey Mayers had charge of

the merchandising and cataloguing of diamonds, watches and jewelry. In each of the taxable years he made a trip to Europe to purchase diamonds, but it was not clearly shown whether he did so on behalf of petitioner or on behalf of the Importing Company. Both brothers had extensive knowledge of the merchandise which they handled. Each worked approximately eight hours a day, but longer hours during the holiday season. They took vacations of two weeks in each of the taxable years. (R. 34–35, 42.)

Prior to 1937, the annual salaries of Lawrence and Chauncey Mayers as officers of the taxpayer were approximately $20,000 each. At a special meeting of the taxpayer's board of directors held on December 31, 1936 (R. 59), at which the brothers were present, their salaries were fixed at $30,000 each, dating retroactively from July 1, 1936. During the fiscal year ended June 30, 1938, the board of directors again fixed their salaries at $30,000 per year each. They drew their salaries monthly throughout the taxable years 1937 and 1938. (R. 35.)

The taxpayer had gross sales in amounts exceeding $2,500,000 in each of the taxable years ending June 30, 1937, and 1938. It reported a net income of $144,044.10 for the taxable year 1937 and $211,769.12 for the taxable year 1938. (R. 35.)

The Commissioner disallowed deductions for compensation to the brothers in excess of $20,000

each (R. 35). The Board of Tax Appeals sustained the Commissioner's action (R. 43), and the Circuit Court of Appeals affirmed (R. 66).

ARGUMENT

The decision below is in accord with the familiar rules governing the reviewability of determinations by the Board of Tax Appeals on issues of fact. *E. g., Wilmington Trust Co.* v. *Commissioner,* 316 U. S. 164; *Helvering* v. *Kehoe,* 309 U. S. 277; *L. E. Pinkham Med. Co.* v. *Commissioner,* 128 F. 2d 986 (C. C. A. 1st), certiorari denied, October 26, 1942, No. 410, this Term. The taxpayer's right to the deduction depended upon its showing the reasonableness of the salaries. *E. g., Long Island Drug Co.* v. *Commissioner,* 111 F. 2d 593 (C. C. A. 2d), certiorari denied, 311 U. S. 680; *E. Wagner & Son* v. *Commissioner,* 93 F. 2d 816, 818 (C. C. A. 9th). The Commissioner's adverse determination was presumptively correct (see *Welch* v. *Helvering,* 290 U. S. 111, 115), and the Board of Tax Appeals, upon review of the evidence, concluded that the taxpayer had not sustained the burden of proving the Commissioner's determination to be erroneous. (R. 41–42.) The Circuit Court of Appeals therefore correctly held that in the absence either of any apparent unreasonableness in the ruling below or of relevant evidence "so compelling that the Tax Court was bound to accept it," the reduction was beyond the reach of its review (R. 66).

The decision is not in conflict, as the taxpayer asserts (Pet. 5, Br. 10), with *Ox Fibre Brush Co.* v. *Blair,* 32 F. 2d 42 (C. C. A. 4th), affirmed *sub nom. Lucas* v. *Ox Fibre Brush Co.,* 281 U. S. 115, *Capitol-Barg Dry Clean. Co.* v. *Commissioner,* 131 F. 2d. 712 (C. C. A. 6th), or *Toledo Grain & Milling Co.* v. *Commissioner,* 62 F. 2d 171 (C. C. A. 6th). These are cases in which the circuit courts of appeals concluded that the Board's determination of a reasonable salary allowance was not supported by the evidence; it is obvious, however, that they turned upon their own facts, and are not inconsistent with a different result on the facts here.

The courts, in these cases, appear to have relied in part upon an inference, or presumption, of reasonableness to be drawn from the directors' action in voting the salaries. But such action, of course, can not be conclusive on the issue (see *Ox Fibre Brush Co.* v. *Blair, supra,* at p. 45), and whatever weight may be given to it must vary with the particular circumstances involved. *Cf. L. E. Pinkham Med. Co.* v. *Commissioner, supra,* at p. 988. Here, as the Board pointed out, the taxpayer's directorate was composed of the recipients of the salaries and their father. The Board regarded this as "a factor not to be overlooked when considering the reasonableness of the salaries." (R. 42.) The cases cited clearly are not authority for the proposition that the directors' action in such circumstances would require reversal of a finding

by the Board that the taxpayer had not sustained the burden of overcoming the Commissioner's determination.

CONCLUSION

The decision below is correct, and there is no conflict. The petition for certiorari should be denied.

Respectfully submitted.

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